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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 754

STATE OF WISCONSIN AND PUBLIC SERVICE COMMISSION OF WISCONSIN, AND PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONERS

v.

FEDERAL POWER COMMISSION, PHILLIPS PETROLEUM CO.

No. 755

PEOPLE OF THE STATE OF CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, PETITIONERS

v.

FEDERAL POWER COMMISSION, PHILLIPS PETROLEUM CO.

No. 756

LONG ISLAND LIGHTING COMPANY, PHILADELPHIA ELECTRIC COMPANY, AND THE UNITED GAS IMPROVEMENT COMPANY, PETITIONERS

v.

FEDERAL POWER COMMISSION, PHILLIPS PETROLEUM CO.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals for the District of Columbia Circuit (No. 754, Pet. App. A) is not

yet reported. The opinion and order of the Federal Power Commission (J. App. 251) are reported at 24 FPC 537, and the Commission's order on rehearing (J. App. 395) at 24 F.P.C. 1008. The decision of the presiding examiner, printed in part at J. App. 35, is reported at 24 F.P.C. 590.

JURISDICTION

The judgment of the Court of Appeals affirming the Commission's order was entered on November 30, 1961. The petitions for writs of certiorari were filed on February 28, 1962. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1) and Section 19 (b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Whether the Federal Power Commission erred in terminating consolidated proceedings under Section 4(e) of the Natural Gas Act involving refunds of increased rates collected during past periods, upon finding that the seller's cost of service exceeded its revenues.

2. Whether the Commission, in a proceeding under Section 5(a) of the Act to fix rates for the future, was required to use the rate-base, cost-of-service, method of ratemaking, despite its conclusion that this method was ill-adapted to producer regulation.

3. Whether California is aggrieved by the Commission's treatment of spiral escalation clauses involved in certain of the Section 4(e) proceedings.

STATUTES INVOLVED

The pertinent statutes, Section 4(e), 15 U.S.C. 717c(e) and Section 5(a), 15 U.S.C. 717d(a) of the Natural Gas Act, are set forth, in the Appendix, *infra*, pp. 24–26.

STATEMENT

The order sought to be reviewed is the culmination of a rate proceeding under Sections 4 and 5 of the Natural Gas Act, undertaken as the result of this Court's ruling in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, that the Federal Power Commission has jurisdiction over the wholesale rates of Phillips Petroleum Company, an independent producer of natural gas. Pursuant to that holding, the Commission on November 22, 1954, vacated its earlier termination of the proceedings and reinstituted its investigation of Phillips' rates under Section 5(a) of the Act. Section 5(a) empowers the Commission to fix rates for the future when it finds that the rates being charged are unjust or unreasonable.

Later, the Commission consolidated this Section 5(a) proceeding (No. G–1148) with twelve other proceedings under Section 4(e) of the Act. Section 4 (e) empowers the Commission to investigate and determine the justness and reasonableness of rates contained in new schedules filed with the Commission to change rates. When new schedules are filed, the Commission may suspend their operation for not more than five months and then permit them to take effect, subject to refund of any part of the new rate that may later be found not justified.

The twelve Section 4(e) proceedings here involved arose from the Commission's suspension of increased rates filed by Phillips. All of these increased rates[1] have been superseded in turn by higher rates which are the subject of other proceedings not now before the court. The total amount of increases involved in these present proceedings is about $5¼ million a year (J. App. 212). Because these rates have been superseded, they have no current or future applicability, but involve only the possibility of refunds, if found to be excessive.

The hearings in the consolidated proceedings covered a total of 82 days between June 26, 1956, and December 18, 1957. The parties, in addition to Phillips and the Commission staff, included 31 intervenors among whom were the present petitioners.

THE EXAMINER'S DECISION

A record of some 27,000 pages was compiled during the hearings and the examiner's decision, which was rendered on April 6, 1959, ran to well over 300 pages. This was the first time that the Commission had an opportunity to examine a major contested case in which an attempt was made to determine just and reasonable rates for an independent producer of natural gas by means of the rate-base, cost-of-service, method used in regulating electric utility and natural gas pipeline rates. The examiner, basing his conclusion mainly on the opinion of the Court of Appeals

[1] With one minor exception amounting to only $21,234 (J. App. 325).

in *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (C.A.D.C.), certiorari denied, 352 U.S. 829, and on *Bel Oil Corp.* v. *Federal Power Commission*, 255 F. 2d 548 (C.A. 5), certiorari denied, 358 U.S. 804, as well as on various Commission orders, decided that this method should be used (J. App. 50, *et seq.*). He found that Phillips' cost of service applicable to jurisdictional sales of natural gas was $57,280,218 (J. App. 214) for the test year 1954. The average unit cost of service he found to be 11.662 cents per Mcf. (J. App. 212.) The examiner then directed (J. App. 214) that Phillips submit rates which would produce total revenues equal to the jurisdictional cost of service as found by him.[2]

COMMISSION ACTION

On September 28, 1960, the Commission issued Opinion No. 338 (J. App. 251–341) covering all 13 of the proceedings involved in the consolidated hearing. In the Commission's view (J. App. 254), the principal question before it was whether the cost-of-service method should be applied in the regulation of producers. The Commission gave a negative answer to this question. The action resulting from the negative answer is the focus of petitioners' attack.

Drawing upon its experience in the instant proceedings and in other producer rate cases during the

[2] The effect of this use of cost of service would be to permit Phillips an aggregate rate increase totaling $14 million, over and above its jurisdictional revenues prior to the filing of Section 4(e) rate increases involved in the consolidated proceeding, or about $8¾ million higher than the $5¼ million increase reflected in Phillips' consolidated Sec. 4(e) dockets, *which the intervenors expressed their willingness to accept.* (J. App. 212).

preceding five years, the Commission held that the rate-base, cost-of-service, method of regulating public utilities is not a workable method of fixing rates for independent producers of natural gas (J. App. 256–269). It found that the ultimate solution of the manifold problems of producer regulation lies in the determination of fair prices for gas as a commodity, taking into account the reasonable financial requirements of the industry, but not the particular costs of each natural gas company. The Commission accordingly announced (J. App. 266) its purpose to fix prices in the various producing areas on a sectional, rather than a company, basis. In addition, it found that to fix Phillips' rates for 1960 and thereafter on the record before it—a record showing Phillips' 1954 cost of service—would be "a result without reason or justice" (J. App. 325).[3]

Simultaneously with its opinion in this case, the Commission promulgated its Statement of General Policy No. 61–1 (J. App. 343, *et seq.*),[4] which set forth prices for natural gas in various producing areas to be used as interim guides for purposes of suspending increased rate filings and certificating new sales.[5] The

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[3] Wisconsin and New York erroneously state (No. 754, Pet., p. 7, note 8) that Commission counsel abandoned this position at the oral argument.

[4] 24 F.P.C. 818; 18 C.F.R. 2.56.

[5] In one major producing area, Southern Louisiana, the "policy" price was subsequently reduced from 21.5¢ per Mcf *not* including state taxes to 21.25¢ *inclusive* of state taxes (amounting, in Louisiana, to 2.3¢ per Mcf). Fourth Amendment to Statement of General Policy, No. 61–1, October 31, 1961.

first two of a series of contemplated area rate hearings are now in progress, one covering the so-called Permian Basin (located in Texas and New Mexico), the other Southern Louisiana.

Although the Commission, in the instant case, declined to attempt to fix future rates on an individual company cost-of-service basis, it did consider Phillips' 1954 costs for purposes of determining whether refunds for past periods were to be ordered under Section 4(e). It arrived, after rehearing, at a total cost of service of $54,525,315 or 11.1009¢ per Mcf (J. App. 401), subject to adjustments for purchased gas costs, gathering taxes and royalties.[*] Finding that revenues from sales within the Commission's jurisdiction for the test year were $45,568,291, resulting in a deficit of almost $9 million, that the increases involved in the proceedings under consideration totaled approximately $5¼ million if allowed in full, and that any adjustments should be proportionate to all contract rates, the Commission concluded that no refund was due. Accordingly, it terminated ten of the consolidated Section 4(e) proceedings and discharged Phillips from any obligation to make refunds thereunder. The remaining two Section 4(e) cases, in which no final order has been entered, constitute two of the three proceedings in-

[*] This means that if Phillips' rates were to be raised so as to cover cost of service, these three items would increase to above the levels at which they are included in the $54,525,315 figure determined by the Commission. The Eastern Seaboard Companies, petitioners in No. 756, pointed out below that this suggests total revenue requirements, after adjustments, of $59,725,315, or a unit cost of about 12.16¢ per Mcf.

volving the spiral escalation clauses to which California refers (No. 755, Pet. 25). The Commission also terminated its Section 5(a) rate investigation proceeding.

THE DECISION BELOW

The Court of Appeals (one judge dissenting in part) affirmed the Commission's order. With respect to the proceedings under Section 4(e), covering rates for the past "locked in" period, the majority said (No. 754, Pet. A–11) "* * * [t]he only question of substance in respect to that period was whether refunds should be made." After pointing out that the Commission determined that Phillips' rates produced some $9 million a year in revenues less than the total cost of service for the test year,[7] the court held (*id.*, A–12–13) that the Commission acted reasonably in concluding that no refunds were due with respect to these past periods. The termination of the proceedings, the court concluded, logically followed from the Commission's "clear decision, after elaborate findings" on the issue of the necessity for refunds: "* * * it terminated them after deciding the basic and dispositive issue, and it entered an order on that decision."

As to the determination of rates for the future, the court held (*id.*, A–13–14) that the Commission was also justified in terminating the proceeding under Sec-

[7] We point out here, as we did below, that no petitioner claims that any of the rates is discriminatory or that there is any evidence in the record to support any rate-by-rate allocation of the cost of service. No party argues that rates should be fixed on any basis other than an over-all one.

tion 5(a). The Commission, the court observed, has inaugurated hearings under the "area-price" method so that it could "design suitable new standards for use in the regulation of producers when it found that the tools at hand were not suited to the purpose." The Commission, it stated, is not bound to apply the formulas for rate-making which were developed for regulating electric utility and natural gas pipeline rates to the essentially different facts and problems found in the untried field of producer regulation. "The Commission abandoned the pending 5(a) proceeding in which it had been endeavoring to establish rates for the future by methods it now deems inadequate. We see no reason why it should not have done so" (No. 754, Pet. App., pp. A–13–14).

Referring to the Commission's Statement of General Policy, the court stated that the adoption of area rates as an interim method of regulation, pending conclusion of the area rate hearings, represents a reasoned decision to abandon an unsatisfactory technique "in favor of a method it deems to be workable and just and reasonable. If that be so, instead of abandoning regulation it is making regulation effective" (*Id.*, A–18). The opinion pointed out that the way is open for consumer interests to challenge the results of the new method, and that, in the interim, new rates and increases will be subject to suspension and refund, so that the rights of customers will be fully protected.

Judge Fahy, dissenting in part, agreed that embarkation on the area rate method does not call for judicial intervention, certainly not at this time (*id.*, A–20). He was of the view, however, that although

it may be appropriate to use the area method in other cases, the Commission should have decided the Section 5(a) aspects of this case on the present record "supplemented as may be found to be reasonably necessary" (*id.*, A-22).

ARGUMENT

The crux of petitioners' contentions is that the Commission has deferred indefinitely the regulation of independent producers of natural gas, has abdicated its statutory duty to regulate, and has left consumers without the protection contemplated by the Natural Gas Act. This is not correct. As the court below correctly held, the terminated Section 4(e) proceedings "presented no questions as to rates to be charged"; and those proceedings were terminated only after the Commission decided "the basic and dispositive issue" whether refunds were due for the past "locked-in" periods (No. 754, Pet., p. A-11-12).

The termination of the Commission's proceeding under Section 5(a), which looked to the fixing of future rates, was also reasonable in light of the Commission's conclusion that the regulation of independent producers of natural gas required a new and different method from that employed in the regulation of electric utility and natural gas pipeline companies.[8] No one can seriously deny that

[8] Note, also, the Commission's finding, *supra*, p. 6, that to fix Phillips' future rates on the basis of the 1954 test year cost of service in the record before it would be "a result without reason or justice."

a regulatory agency has broad discretion in selecting an appropriate means or method of regulation. As all of the members of the court below agreed, the Commission's decision to embark upon a method of area pricing does not require, if indeed it would permit, judicial intervention at this time. In the interim, the Commission is employing the guide rates set forth in its Statement of General Policy in order to "hold the line" and protect consumers. As the Court of Appeals emphasized, no question as to the validity of these guide rates was before it (*id.*, A–16–17).

1. With respect to the refunds for the past periods involved in the consolidated proceedings under Section 4(e), the record shows that the cost of service exceeded revenues. As the court below pointed out (*id.*, A–11), the one substantive issue before the Commission in those proceedings was whether to order refunds; on that issue, it made a definitive decision, based upon elaborate findings. The court found it immaterial that the Commission did not precede its ultimate conclusion of "no refund" with an intermediate conclusion using the words "just and reasonable". The ultimate conclusion is fully warranted by the facts found from the record; yet petitioners seek review of the proceedings, not because the ultimate conclusion was erroneous, but because the intermediate conclusion was not stated in a particular verbal formula.

All of these proceedings were begun as the result of price increases filed between August 31, 1954, and September 10, 1956. Their termination was based on

the finding (J.A. 325–6) that cost of service for the test year 1954 exceeded revenues by substantially more than the amount of the proposed increases. Petitioners do not claim that the test year was unrepresentative, and the record affirmatively shows that 1956 costs were substantially the same as those for 1954 (J.A. 272). The Commission was thus clearly warranted in deciding that no refunds should be ordered with respect to the proceedings here involved, which comprised all of Phillips' increased rate proceedings pending on December 14, 1956, the date of the last consolidation order. Furthermore, all of these increases have since been superseded by others and the decision here is not of any future significance.

It is not true that the Commission relied on its knowledge of increased costs in years subsequent to the test year for the purpose of terminating these proceedings under Section 4(e) (see Pet. No. 754, p. 6). The Commission's observation as to post-test-year costs and revenues (R. 329) was merely a basis for suggesting that it "may be reasonable" to terminate some of the *other* proceedings, relating to post-1956 increases not involved in this case, and for inviting "the filing of motions to this effect." As the Commission observed, "All parties to these proceedings would, of course, have opportunity to object to such motions." It is erroneous to suggest that the Commission has approved any rates except those before it in this case, or that it approved even these rates (relating only to past periods) on any basis except the very cost-of-service method for which petitioners contend.

2. The Commission, in explaining its termination of the proceeding under section 5(a), gave cogent reasons for declining to fix future rates on an individual company cost-of-service basis, and its reasons were not challenged. It observed, first, that the cost-of-service method, with its emphasis on return on investment, penalizes the efficient or fortunate producer and unduly rewards the inefficient or unfortunate one. Unless a producer has bought developed acreage at a fair price, there is no meaningful relationship between investment and return. He who takes the largest development risk usually pays less for his rights, and hence has a smaller investment, than those who follow him.

The Commission stated further that difficulties of cost allocation (as between jointly produced gas and oil) and the fact that unit costs of gas must be calculated from highly variable and often inaccurate reserve estimates are factors throwing doubt on the validity or usefulness of the cost-of-service method. It observed that the individual-company-cost approach to rates encourages leasing to the higher-cost producers because the lessors (*i.e.*, the royalty owners) receive a percentage of the price. It pointed out that this method would also require it to hold repeated rate cases, often of great size and complexity, for each producer.

An alternative to the rate base method is the determination of fair prices for gas based on the reasonable financial requirements of the industry, rather than by reference to the rate base and expenses of each company. This method does involve the use of

typical or composite cost data, but only as a part of the body of economic information necessary for intelligent regulation of the industry. The "ultimate objective will be to set prices in all producing areas which will be adequate to maintain the gas supplies needed by the consumers of the nation, but at prices that are no higher than are necessary to accomplish that purpose" (J.A. 266).[9]

Instead of an "indefinite deferral" of the fixing of just and reasonable rates, there are now in progress proceedings to fix such rates in two of the country's major producing areas, which are also two of Phillips' largest producing areas. Similar proceedings in other areas will follow. As the court below observed, to adopt a more manageable technique of control over prices is not to abandon regulation but to make it more effective.

In insisting that the Commission use individual company cost of service as a basis for future rates, petitioners are asking this Court to do what it has con-

[9] Although the membership of the Commission has changed completely since this case was decided at the administrative level, the Commission has adhered to the view that the area approach should be pursued. "If we can set a path and dispose of these producer rate cases in these areawide cases, we will have achieved something that the industry is looking for and also something the public is looking for, because these are the increases that go up the line to the pipelines and to the distributing companies and are paid by the consumers. Your whole regulatory pattern is thrown into chaos when these producer rates are triggered and go up from time to time." Testimony of Federal Power Commission Chairman Joseph C. Swidler, Hearings, Committee on Appropriations, United States Senate, 87th Cong., 2d sess., on H.R. 11038, p. 106.

sistently refused to do in the past—to fasten a particular method of rate-making upon an administrative body. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602. See, also, *Bel Oil Corp.* v. *Federal Power Commission*, 255 F. 2d 548 (C.A. 5), certiorari denied, 358 U.S. 804, in which the Fifth Circuit pointed out that the problems inherent in the regulation of independent natural gas producers are unique and require the development of new tests and techniques.[10]

3. When the Commission decided that the area method, rather than individual company cost of service, was the appropriate way to fix Phillips' rates, it was confronted with the question of how to prevent a hiatus in regulation during the pendency of the area rate hearings. All the increased rates in the Section 4(e) proceedings in this case were filed before September 11, 1956, and were found, on the basis of a full record, to result in a rate level below cost of service (see *supra*, pp. 11–12). Petitioners suggest that Phillips' subsequently filed increases (which are involved in other Section 4(e) proceedings) may have raised revenues above cost of service. They argue that the Commission could determine whether that is so by reopening the proceedings and obtaining

[10] In other fields as well, this Court has held that the choice of the method whereby statutory policy is to be implemented is peculiarly a matter for administrative competence. *Phelps Dodge Corp.* v. *National Labor Relations Board*, 313 U.S. 177; *American Power & Light Co.* v. *Securities Exchange Commission*, 329 U.S. 90.

cost-of-service data for a more recent test year; that if it then found that cost of service did not justify the post-1956 increases, it could prescribe rates on that basis (notwithstanding its dissatisfaction with the cost-of-service approach); that this would result in a quicker decision than the use of the area method; and that therefore it is obligatory upon the Commission to continue to apply a cost-of-service method to Phillips.

The Commission's conclusion was that, instead of reopening the proceedings to attempt to make another determination of cost of service for a new test year, it should use the area method both for fixing Phillips' future rates under Section 5(a) and for determining refunds of the increased rates which had not been consolidated in the present proceedings. The Commission, while it pursues this task, is keeping Phillips' rates under control. Its Statement of Policy clearly shows how this control will be exercised as to all companies, including Phillips (see *supra*, pp. 6–7). To assert, as do Wisconsin [11] and New York, that the termination of the Section 5(a) proceeding represents "an indefinite deferral of exercise of jurisdiction" is erroneous.

Fully realizing the importance of interim controls while it is going forward with the area rate proceedings, the Commission announced in its Statement of General Policy that it would be guided by the rates listed in the Statement, in (1) conditioning proposed initial prices in certificate proceedings, and (2) exer-

[11] In the court below, Wisconsin did not challenge the termination of the proceeding under Section 5(a).

cising its power to suspend proposed rate increases.

The Statement contains two sets of prices, one of which applies to rates for initial service and the other to proposed increases in rates for service already established. In most instances, the latter are considerably below the former (J.A. 348). It is this lower set of prices which guides the Commission's action in relation to proposed changes in the price of any gas now flowing.

The higher set will guide it in fixing the initial price for "new" gas. But the price to be fixed in future certificates is not an issue in the instant case and would not be decided if the Commission were compelled to proceed with the Section 5(a) case against Phillips. It is therefore irrelevant to argue (No. 754, Pet., pp. 15–20) that these prices are comparable to the highest current prices.[12] Petitioners can litigate the grant of new certificates in appropriate cases if they are aggrieved by too high an initial price, as *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378 (the *Catco* case), amply demonstrates.[13]

The other prices in the Statement of General Policy, those governing rate increases, are markedly below

[12] Also, we dispute the factual premises of the argument. The Commission set forth (J.A. 345) the factors it took into account in arriving at the levels set forth in the Statement of General Policy. Existing and historical price structure constituted only one factor among many. See, also, note 5, p. 6 *supra*.

[13] Upon remand to the Commission, the "Catco" initial price was reduced from 21.4¢ to 18.5¢ and refunds of the difference were ordered from the date of initial delivery. Opinion No. 351, January 22, 1962 (not yet officially reported).

current levels in virtually every case. Nowhere (except in West Virginia, where Phillips has no production) do they exceed 14¢ (J. App. 348).[14] When it is remembered that Phillips' revenue requirements *in 1954* were 12.16¢ (*supra*, p. 7, n. 6), there would seem to be no doubt that prices ranging from 14¢ down to 11¢ protect the public during the interim period. The largest part of Phillips' sales in the test year were in the Permian Basin and Oklahoma Panhandle areas (J. App. 15), where the price set forth in the Policy Statement is 11¢ (J. App. 348). The suggestion that the Commission is about to let prices run wild until area prices are fixed is entirely without foundation.

The total situation with respect to Phillips's rates presents an excellent example of the Commission's vigorous protection of the consumer pending the establishment of a satisfactory method of fixing producer rates. No less than 79% of the volume of gas which Phillips sold in 1960 was sold under rate schedules having refund conditions attached. Over 82% of its total dollar revenues came from these schedules.[15]

The reason those schedules have refund conditions attached to them is that when they were filed (as rate

[14] In four districts in Texas, the Commission, by a Policy Statement amendment, permits increases up to 14.6¢ and 15¢ in certain exceptional circumstances. The increases are permitted contingent upon the elimination of favored-nation provisions and price redetermination provisions from the rate schedules and upon the elimination or limitation of price escalation clauses. Only a very small portion of Phillips' output is in these areas.

[15] Computed from figures shown in Federal Power Commission Form 301 filed by Phillips for 1960 (latest available).

increases superseding the previously established schedules) the Commission promptly suspended them. The schedules which were not suspended and hence do not have a refund obligation produced revenues of only ~~$16,248,005~~ 16,421,282 out of Phillips' total 1960 revenues of $90,859,248. The amount of gas sold under those schedules was 133,266,144 Mcf.[16] Thus the average price of the gas sold free of refund obligation *in 1960* was only ~~12.2¢~~ 12.3¢ per Mcf—a figure approximately equal to the *1954* revenue requirements per Mcf on a cost-of-service basis (see *supra*, pp. 7, 18).

4. Petitioners argue that the opinion below is inconsistent with the same court's decision in *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (C.A.D.C.), certiorari denied, 352 U.S. 829, in that it permits reliance on "fair field prices" in determining just and reasonable rates.[17] Patently, there is no basis for this contention.

The Commission has not proposed to use "fair field prices" for any purpose. The "policy prices" which guide its exercise of the power to suspend rates are, indeed, far below current prices. They serve to protect the consumer (through imposition of the refund obligation which flows from suspension) pending a

[16] *Id.*

[17] The holding of the *City of Detroit* case was that *a pipeline* which owns producing wells may not include the "fair field price" of the gas from those wells as an element of its actual cost of service. If there were inconsistency (which we dispute), there would still be no intercircuit conflict.

final determination of just and reasonable rates in area proceedings. Nor is there any basis for an inference that these final determinations will be governed by field prices. In any event, there was no question before the Court of Appeals concerning the computation of any guide rate set by the Commission;[18] and, obviously, there can be no valid challenge to the basis of area rates not yet determined or established.

5. California advances a separate contention relating to spiral escalation clauses, *i.e.*, clauses which permit a producer to raise its price to a pipeline when an increase in a price index or an increase in the pipeline's resale rates has taken place.[19] In the court below, Wisconsin and California contended that the Commission's order should be set aside because it does not hold such clauses to be void as a matter of law. Wisconsin abandons that contention here, but California urges it as a reason for granting certiorari. Contracts containing spiral escalation clauses are involved in three of the thirteen proceedings covered

[18] The court below stated: "Let us emphasize that we do not have before us at this time the question whether any rate set by the Commission as a guide rate falls within the area of reasonable computation. That question is emphatically left open by the Commission, and by us, for consideration when some one or more of the selected guide rates is attacked, by a producer, a customer, or a consumer." (No. 754, A–16–17).

[19] The terms of the contracts which California attacks are not in the record before this Court. California is evidently asking for a general opinion on all spiral escalation clauses, without having considered it necessary to bring any one of them to the Court's attention.

by the Commission's order. Two of those three proceedings were not terminated because there remains for decision the question whether the escalation clauses had been triggered according to their terms. Since in those proceedings no final order has been entered, the court below correctly held that the attack was premature. California's complaint thus comes down to one proceeding, Docket G–10793, a Section 4(e) proceeding in which the proposed rate, giving effect to the spiral escalation clause, is 10.858¢.[20] The rate involved is a rate charged to Michigan Wisconsin Pipe Line Co., and although Wisconsin, which has abandoned the point, is affected by the rate, California is not.

The Commission itself last year adopted a regulation[21] providing that spiral escalation clauses in contracts tendered for filing as rate schedules after April 3, 1961, "shall be inoperative and of no effect at law." Thus, the Commission prohibited the filing of increases based on such clauses as being against the public interest. It has now prohibited the filing, after April 2, 1962, of contracts containing such clauses. To strike them from contracts already filed, however, might deprive the producer of a part of the consideration for which he agreed to sell his gas.

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[20] This rate is less than Phillips' cost of service. It appears in Wisconsin's brief below, though not in the record designated in this Court.

[21] Order No. 232A, 26 F.R. 2850, amending Section 154.93 of its General Rules and Regulations, 18 C.F.R. 154.93. This has been further amended by Order 242, 27 F.R. 1356, which prohibits the filing on or after April 2, 1962, of rate schedules containing spiral escalation clauses.

Assuming, *arguendo,* that this could be done, the legal and regulatory problems resulting from it might cause material harm to the public—harm that might well exceed the injurious effects of the escalation provisions themselves. For instance, if the voiding of such a provision made the entire contract voidable, the producer could then change rates at will, unhampered by contractual limitations, and file increases whenever it chose. In that way, the uncertainty inherent in spiral escalation clauses would be compounded, see *Southwestern Sugar & Molasses Co., Inc.* v. *River Terminals Corp.,* 360 U.S. 411. Here, there is no question of allowing spiral escalation clauses to permit Phillips to charge whatever the clauses may call for. The most any such clause can do is to permit a new filing, and when a filing is made it becomes subject to Commission scrutiny, *i.e.,* to exercise of the suspension power and the fixing of a just and reasonable rate.

The question at bar (if California can properly raise it) is not whether rates should be allowed to increase automatically under spiral escalation clauses, but merely whether the clause involved in one of the thirteen proceedings represents a valid consent by the customer to an increased-rate filing by Phillips, subject to all the safeguards provided by the Act. This Court has previously refused to review a case in which a court of appeals declined to treat a spiral escalation clause as a nullity (*Phillips Petroleum Co.* v. *Federal Power Commission,* 227 F. 2d 470 (C.A. 10), certiorari denied, *sub nom. Michigan Wisconsin Pipeline Co.* v. *Phillips Petroleum Co.,* 350 U.S.

1005), and has sustained a contractual arrangement under which there was no limit whatever on the seller's right to file for increases (*United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division*, 358 U.S. 103). Clearly, California's argument on this point is without merit.

CONCLUSION

For the foregoing reasons the petitions for writs of certiorari should be denied.

Respectfully submitted.

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APPENDIX

The Natural Gas Act, Section 4(e), 15 U.S.C. 717c (e) and Section 5(a), 15 U.S.C. 717d(a), provides as follows:

> SEC. 4. (e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided,* That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposd change of rate, charge, classification, or service shall go into effect.

Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 15 U.S.C. § 717c]

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such

increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

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